THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. (D.P.U.) No. 97-96

Investigation by the Department of Public Utilities Upon Its Own Motion Commencing a Rulemaking, Revising Standards of Conduct Governing the Relationship Between Gas and Electric Distribution Companies and Their Unregulated Marketing Affiliates

REPLY COMMENTS OF CABLEVISION SYSTEMS CORPORATION

Cablevision Systems Corporation ("Cablevision") hereby replies to comments submitted in response to the notice of proposed rulemaking by the Department of Telecommunications and Energy (the "Department") in this docket.[1] In its initial comments, Cablevision urged adoption of the Department's proposal to extend its Standards of Conduct for affiliated transactions to gas and electric utility affiliates engaged in nonenergy businesses. Cablevision believes that such standards are necessary to protect both ratepayers of regulated distribution companies and competition in nonenergy markets, such as telecommunications. As stated in Cablevision's initial comments, incentives to cross-

[1] Comments were filed by the following parties: the Attorney General of the Commonwealth of Massachusetts ("Attorney General"); Edison Electric Institute ("EEI"); Eastern Edison Company ("Eastern Edison"); jointly, Eastern Power Distribution, Inc. and Eastern Energy Marketing, Inc. ("Eastern Group"); New England Cable Television Association, Inc. ("NECTA"); Bay State Gas Company ("Bay State Gas"); Berkshire Gas Company ("Berkshire Gas"); Boston Edison Company ("Boston Edison"); Boston Gas Company ("Boston Gas"); jointly, Cambridge Electric Light Company, Commonwealth Electric Company and Commonwealth Gas Company ("Cambridge/Commonwealth Companies"); Colonial Gas Company ("Colonial Gas"); Enron Energy Services ("EES"); Essex County Gas Company ("Essex Gas"); Fitchburg Gas and Electric Company ("Fitchburg Gas and Electric"); Fall River Gas Company ("Fall River Gas"); jointly, Locals 273, 369, 387, 392 and 431 of the Utility Workers' Union of America, AFL-CIO, and the Massachusetts Alliance of Utility Unions ("Unions"); Western Massachusetts Electric Company ("WMECO"); Massachusetts Electric Company ("Mass. Electric"); NEV East, LLC ("NEV East"); and Green Mountain Energy Resources, LLC ("GMER").

subsidize or give preferential access to affiliated business ventures to gain advantage in competitive markets exist regardless of whether the other business ventures are energy-related.

For reasons set forth below, these incentives to cross-subsidize are a particular concern when electric utility affiliates enter the telecommunications market. The 1996 Telecommunications Act seeks to open up competition in local exchange service through development of facilities-based competition. If potential new entrants into the local exchange marketplace are unable to compete on equal terms with affiliates of traditional utilities, new investment in competitive services will be frustrated. If the Department fails to protect against this outcome while electric utilities are staking out converging markets, it may lose the opportunity to introduce competition.

Cablevision believes that unless the Department extends its Standards of Conduct to all affiliates of electric and gas distribution companies, the Department will be forced to deal with the issue of improper cross-subsidization time and time again. Commenters opposed to extension of the Standards of Conduct do not refute – indeed, they recognize -- the need for the Department to address such cross-subsidization but merely suggest that it should be addressed by after-the-fact cost allocation and ratemaking instead of prevented through standards. Cablevision submits that prevention is more effective protection for ratepayers and competition, more efficient for the Department, and more consistent with the Department's statutory responsibilities.

In these reply comments, Cablevision makes the following arguments in response to comments and testimony to date:

(1) that the application of the Standards of Conduct to insure that monopoly assets are not exploited by competitive affiliates engaging in

nonenergy-related business would not unfairly burden such affiliates in comparison with their non-affiliated counterparts;

(2) that such application of the Standards of Conduct to competitive affiliates engaging in nonenergy-related business similarly would not inhibit economies of scale, economies of scope, and greater efficiency;

(3) that the monopolies enjoyed by electric and gas distribution companies in their retail sale of energy do confer special advantages upon them in nonenergy-related lines of business, including the cable and telecommunications businesses;

(4) that prevention of cross-subsidization of competitive activities through cost allocation rules or in ratesetting proceedings, rather than preventing them through the Standards of Conduct, is belated and ineffective;

(5) extension of the Standards of Conduct is effective protection of competition, rather than competitors;

(6) the recently-enacted Restructuring Legislation enhances, rather than inhibits, the Department's authority under Chapter 164 to promulgate Standards of Conduct pertaining to competition in nonenergy-related markets.

1. Extension of the Standards of Conduct to Competitive Affiliates Engaging In Nonenergy-Related Business Would Not Unfairly Burden Them in Comparison With Their Non-Affiliated Counterparts.

Several parties opposing broader application of the Standards of Conduct contend that such extension would place affiliated companies at a disadvantage when competing in nonenergy-related markets. However, protection against cross-subsidization or discrimination hardly tilts the playing field in favor of non-affiliated competitive entities; it merely prevents the affiliated entities from having an unfair competitive advantage, namely the use of ratepayer funded assets or other advantages accruing from the regulated utility's monopoly position.

Peter Bradford, who has had a distinguished career in utility regulation, testified before the Department in this docket on December 8, 1997. He testified that although he disagrees with Dr. Alfred E. Kahn on the issue of the appropriate mechanisms for protecting monopoly ratepayers from the effects of cross-subsidy driven overcharges or depletion of assets, he agrees with Dr. Kahn's assessment that:

> so long as . . . monopoly companies are subjected to rate of return regulation on their total operations, it is in their interest to recover as much as possible of their aggregate revenue requirements from their monopoly customers, because that will give them the greatest possible advantage in their competitive markets.

(Bradford Testimony at 2)(attached as Appendix 1). Mr. Bradford cited his own experience and a score of published cases and reports revealing abuses of monopoly power to benefit competitive affiliates, such the notorious NYNEX Materials Enterprises matter, which are elaborated in Appendix 2 to these reply comments. Based on this experience, Mr. Bradford concluded that abuse of monopoly consumers in a relationship with competitive affiliates is not only likely but "statistically inevitable" in any state that contains a significant quantity of such combinations, and where the resources devoted to utility regulation are a tiny fraction of the revenue flows of the utilities. (Bradford Testimony at 3, 4.)

When regulated energy distribution companies improperly exploit ratepayer-derived assets by cross-subsidizing their competitive affiliates, the result is antithetical to the public interest. First, the ratepayers are unfairly burdened with the cost of subsidizing the distribution company's entry into a nonenergy-related market, without any commensurate benefit accruing to them. Second, because cross-subsidization of the competitive affiliate affects the ability of other, unsubsidized competitors to compete in the same market, legitimate competition is impeded and the market becomes distorted. That risk is at least as great with developing telecommunications communication as it is with energy-related markets.

Application of the Standards of Conduct to affiliates engaging in nonenergy-related business would reduce the incentives for cross-subsidization. This, in turn, would lead to a reduction in the incidence of anticompetitive conduct and ratepayer abuse, thus saving the Department from having to deal with such "statistically inevitable" conduct and abuse on a recurring basis. Compliance with the Standards of Conduct would not impose an asymmetrical burden on competitive affiliates. To the contrary, it would simply require them to compete with their unaffiliated counterparts on an equal footing, without gaining unfair advantage from their relationship to their corporate parent.

Although Cablevision believes that extending the Standards of Conduct to nonenergy markets would clearly help to prevent anticompetitive conduct and ratepayer abuse that is otherwise highly likely to occur, it also believes that, as Mr. Bradford proposed during his testimony, the Department could adopt waiver provisions allowing it to suspend the rules in situations where a company's good conduct over a period of time and public interest considerations warrant the granting of such a waiver. (Bradford Testimony at 4). Such a waiver provision would enable the Department to address concerns such as those of Commonwealth Electric Light Co., Cambridge Electric Light Co., and Commonwealth Gas Co. that extension of Standards of Conduct could inhibit the combining of certain operations of internal units or divisions, without needing to carve entire areas out of the Standards of Conduct that could be open to abuse.

2. Application of the Standards of Conduct To Competitive Affiliates Engaging In Nonenergy-Related Business Will Not Inhibit The Achievement of Economies of Scale, Economies of Scope, And Greater Efficiency.

EEI and Mass. Electric contend in their comments that extension of the Standards of Conduct to competitive affiliates is incompatible with achieving greater synergies and efficiencies (EEI at 3; Mass. Electric at 1-2.). Cablevision disagrees. As set forth above, the Standards of Conduct would simply require that energy distribution company affiliates and non-affiliates compete on an equal footing when transacting nonenergy-related business. All businesses seek to achieve economies of scale, economics of scope, and greater efficiency, and regulated utilities may do so also, providing they do not exploit their monopoly position – as Professor Kahn, among others, recognizes in conceding the need to regulate transfer pricing. Extension of the Standards of Conduct would assure that that regulated companies do not exploit their distribution monopoly in any other markets.

Notwithstanding the argument by utilities in this proceeding that separations requirements applicable to nonenergy-related affiliates would inhibit economies of scale and scope, in support of its proposal to establish an unregulated holding company, Boston Edison has endorsed just such separations. In that proceeding, Boston Edison's expert John J. Reed testified to the benefits of such separations:

> Separating regulated and unregulated services defines clear and distinct lines of authority, communication, responsibility, and regulation which provides additional protection for the captive customers of monopoly services. Separation also promotes competition in the regulated market segments by requiring all market participants to operate under the same set of rules. … A holding company structure creates a well-defined legal and accounting separation between regulated and unregulated activities. This separation results in barriers to cross-subsidization between utility and non-utility businesses that are greater than with cost and revenue allocation. Because two separate companies now exist, there is little to no cost allocation.[2]

3. The Monopolies Enjoyed By Electric And Gas Distribution Companies In Their Retail Sale of Energy Confer Upon Them Special Advantages In Other Lines of Business, Including The Cable And Telecommunications Businesses.

Numerous commenters opposed to extending the scope of the Standards of Conduct contend that their electric and gas monopolies do not confer any special advantage on them in other lines of business. This is simply not the case. It is precisely because of such monopolies that electric and gas distribution companies have been able to acquire, in a regulated environment with ratepayer funds, their present-day infrastructure, employees, customer lists, databases, goodwill, and other assets. Goodwill, as Assistant Attorney George Dean testified in this docket on December 8, 1997, is primarily a function of recognition; gas and electric distribution companies have universal recognition in their service areas because they are the only game in town. Goodwill also is a function of advertising, and customers have paid millions of dollars for gas and electric company advertising over the years, giving them a strong claim to royalty payments.

In addition, as Mr. Bradford testified, a utility company has a special advantage in communications markets in that it controls access to essential facilities, such as utility poles, permits,

[2] Direct Testimony of John J. Reed at 5, 7, D.P.U. 97-63 (filed Sept. 5, 1997). Because Mr. Reed's testimony so clearly supports the principles underlying the Department's proposed Standards of Conduct, Cablevision submitted a copy of his testimony with its initial comments in this proceeding.

rights-of-way and conduits. (Bradford Testimony at 2.) A potential new entrant into telecommunications markets faces a requirement for substantial investment in new facilities of many sorts. Many of these facilities have been made available to electric utilities or have been constructed by such utilities as part of their monopoly electric business over the years. To the extent that these facilities are difficult or impossible for a new entrant to replicate, electric utilities' ability to confer them on an affiliate on uniquely favorable terms is a significant and unfair barrier to entry by other such as Cablevision.

The special advantage that the electric distribution companies have in the cable and telecommunications business is clearly identified in the recent National Regulatory Research Institute report, "Exempt Telecommunications Companies and Some State Commission Regulatory Implications of Electric and Telephone Convergence" (Sept. 1997)("ETC Report") (attached as Appendix 3). According to this report, electric utilities have expanded their communications infrastructure to take advantage of wholesale markets that are the result of the enactment of the Energy Policy Act of 1992 and the propagation of FERC Orders 888 and 889. These communications systems can be used to diversify into nonenergy-related retail activities. The excess capacity on the electric utilities' communications system can be used to provide telephone service, data and information service (including Internet access), as well as video service.

According to the ETC Report, electric utilities typically use only about 3 percent of their communications capacity for their own purposes.[3] This creates a special advantage for electric distribution companies. They have available an infrastructure with excess capacity, which has been

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[3] *ETC Report* at 8.

acquired with ratepayer money. It is essential to protect both ratepayers and competition in the telecommunications industry and insure that this excess capacity not be utilized unfairly.

The ETC Report also warns state commissions to be on guard against preferences that the electric utilities might employ. The utilities' infrastructure must be available to all competitors of their nonenergy affiliates on a nondiscriminatory basis. As the ETC Report recognizes, state commissions can protect against preferences by enacting Standards of Conduct "...to make certain that all parties are treated comparably, if not the same, by the electric utility..."[4]

4. Extension of The Standards of Conduct To Energy Distribution Company Affiliates Engaging In Nonenergy-Related Business Will More Effectively Prevent Cross-Subsidization of Competitive Activities Than Resorting to Cost Allocation Rules or Ratesetting Proceedings.

EEI and eight other commenters, as well as Professor Kahn, recognize that entry into competitive businesses by electric utilities raises cross-subsidization concerns that requires regulation of affiliate transactions. They suggest, however, that such regulation can be addressed by ratemaking proceedings and cost allocation. In effect, these parties accept Mr. Bradford's premise that abuse of monopoly customers is statistically inevitable, but urge that it is preferable to the cleanup of such abuses after the fact rather than to prevent them. As Mr. Reed points out for Boston Edison, however, well-defined separation is more efficient because it avoids the need for cost-allocation.[5]

Even if such abuses could be addressed effectively after-the-fact by refunds or rate adjustments, such relief affects only the regulated company and does not alter the competitive advantage gained by the unregulated affiliates. The retroactive protection it offers ratepayers is

[4] *Id.* at 21.
[5] *See* text and note at note 2, *supra*.

ineffective: because of turnover in the customer base, it does not reach all the ratepayers who have paid cross-subsidies, thereby resulting in intergenerational inequities. It is a poor substitute for fair rates in the interim.

Finally, as the Department moves away from traditional cost-of-service regulation of the electric industry, there is no assurance that there will even be rate proceedings that ensure review of transfer pricing or cost allocation in affiliate transactions. Some electric industry restructuring settlements provide rate freezes for a period of years, deferring any form of ratesetting.[6]/ The Department may well adopt incentive regulation for the electric utilities (as it has already done in telecommunications). Thus, suggestions that the issues addressed by Standards of Conduct be deferred for consideration in ratesetting proceedings may result in no review at all. Adoption of the proposed Standards of Conduct will enable the Department to prevent cross-subsidization, which will protect ratepayers and ensure fair competition in nonenergy-related markets.

5. The Purpose of The Standards of Conduct Is To Protect Competition, Not Competitors.

Cablevision fully agrees with EEI that the purpose of the Standards of Conduct is to protect competition, not competitors. This is the very reason that Cablevision believes that the Standards of Conduct should be extended to the nonenergy-related markets in which competitive affiliates transact business. EEI, however, in portions of its comments stands this statement on its head by focusing mainly on the restrictions such Standards would place on electric and gas distribution companies, and by ignoring or downplaying the incentives that presently exist for such companies to exploit their assets by cross-subsidizing their unregulated nonenergy-related affiliates, leading to distortion and the restraint of competition in the markets in which such affiliates compete. As the ETC Report states:

[6]/ *See, e.g.,* Boston Edison Company Restructuring Settlement Agreement, D.P.U. 96-23 (filed June, 1997).

> [T]he purpose of a utility affiliate standard of conduct is not to **disadvantage** utility affiliates, such as ETCs relative to competitors. Rather it is to ensure that utility affiliates, such as ETCs, do not **gain** an unfair advantage over other market players.[7]

What EEI and others appear to be saying, on the other hand, is that if utilities are prevented from using their monopoly position to gain an advantage, their competitive affiliates will be at a disadvantage. It is precisely such advantage that can deter competitive investment in new telecommunications facilities.

6. The Department Has the Authority Under Chapter 1642 To Prescribe Standards of Conduct for Competition In Nonenergy-Related Markets.

As several commenters stated in their initial comments, the Department already has concluded that Sections 76A, 76C, 85, 85A, 94A, 94B and 94C of M.G.L. c. 164 all furnish ample authority to review and prescribe a distribution company's relationship with its affiliates, including regulation of nonenergy-related activities. Standards of Conduct, D.P.U. 96-44, at 7 n.5 (Dec. 30, 1996). These statutes fully support the Department's interpretation of its jurisdiction, and, as demonstrated below, nothing in the recently enacted electric industry restructuring legislation, or in the comments and testimony submitted in this proceeding, should cause the Department to retreat from that position.

Those parties questioning the Department's jurisdiction to regulate transactions with nonenergy-related affiliates rely largely on vague policy arguments that ignore the specific statutory grants of authority found in M.G.L. c. 164, sections 76A, 76C, 85, 85A, 94A, 94B and 94C. Boston Edison, for example, merely offers the circular argument that the Department cannot promulgate the proposed regulations because they are not in the public interest. Presumably Boston Edison must also accept the

[7] *Id.* at 22 (emphasis an original).

converse proposition, i.e., that the Department does have jurisdiction to issue the regulations if it concludes that they are in the public interest. Indeed, in its comments on the consistency of its proposed restructuring settlement agreement with the new restructuring legislation, Boston Edison contends that provisions of the legislation "provide the Department with broad authority and discretion to issue regulations and make determinations consistent with its authority."[8]

Other commentators base their arguments on unjustifiably narrow readings of the relevant statutes. Bay State Gas and Fitchburg Gas and Electric, for example, claim that under Section 76A the Department has jurisdiction only over transactions with energy-related affiliates, because only such transactions could affect the operations of such gas or electric company within the meaning of the statute. But obviously the subject company's operations can be affected by transactions with nonenergy affiliates as well. For example, an electric company's employees might be used to repair wires for a telecommunications affiliate. If the electric company were not compensated adequately for such usage, or if the practice deprived the electric company of adequate manpower in an emergency, that situation undoubtedly would affect the electric company's operations.

7. The Restructuring Legislation Enlarges, Rather Than Limits, The Department's Authority To Extend Standards of Conduct To Nonenergy-Related Affiliates.

The new electric industry restructuring law, Chapter 164 of the Massachusetts Acts and Resolves of 1997 ("the Act"), in no way restricts the Department's pre-existing authority to regulate nonenergy-related affiliates of electric and gas companies. On the contrary, the Act mandates

[8] Boston Edison Company Comments Concerning Compliance with Massachusetts Restructuring Legislation, D.P.U. 96-23 at 2 (filed December 15, 1997).

Standards of Conduct and assigns the Department oversight authority over mitigation of stranded costs that is complemented by Standards of Conduct.

Section 1C of Section 193 of that act mandates that the Department shall promulgate standards of conduct that ensure the effective separation of gas and electric distribution companies and their competitive affiliates, i.e., any marketing, generation, transmission, or distribution affiliate of an electric company. As the Hearing Officer noted at the December 8, 1997 hearing in this matter, the new law does not define the term "marketing company." (Dec. 8, 1997 Transcript at 205.) Since an electric company might market telecommunications services as well as energy services -- in fact, some utility companies have proposed bundling energy and nonenergy services in a single consumer package -- there is no reason why this mandate should be interpreted as applying only to energy-related affiliates.

Indeed, the intended application of the particular standards of conduct set forth in Section 1C may be even broader, including not only marketing, distribution, generation, and transmission affiliates, but any affiliate of an electric company. In proceeding to detail specific standards of conduct, Section 1C uses the terms any affiliates, any affiliate, or an affiliate in clauses (i), (iv), (v), (vi) and (vii), but refers to any generating or marketing affiliate in clause (viii). This distinction suggests that most of the standards were intended to apply to all electric company affiliates, while the prohibition on sharing employees in clause (viii) is more limited in its application.

This interpretation of the standards in Section 1C is the direct corollary of the argument made by WMECO, in its comments filed in this docket. WMECO argues that clause (viii) applies only to sharing of employees between distribution companies, on the one hand, and generating or marketing affiliates, on the other, but not to sharing between a distribution company and other affiliates. If, as

WMECO contends, the presence of the modifiers generating and marketing in clause (viii) is significant, then the absence of those terms in the previous clauses of Section 1C must be equally significant, suggesting that those restrictions were intended to apply to all affiliates of a distribution company.

In any event, even assuming that a more restrictive interpretation of the scope of Section 1C could be justified, the new legislation would not alter the Department's already existing power to regulate nonenergy-related affiliates of electric and gas companies, as provided in the other statutes cited above. A specific authority to act in a particular respect does not bar other action that is consistent under general statutory authority. *Massachusetts Elec. Co. v. DPU,* 419 Mass. 239, 246 (1994). Certainly, there is no express language in the new law that repeals the other grants of authority to the Department found in M.G.L. c. 164, Sections 76A, 76C, 85, 85A, 94A, 94B and 94C.

Moreover, "[i]mplied repeal of a statute is not favored and will be found only when the prior statute is so repugnant to, and inconsistent with, the later enactment that both cannot stand". *LaBranche v. A.J. Lane & Co.,* 404 Mass. 725, 729 (1985). In this case, there is no such contradiction between Section 1C and the other statutes from which the Department draws its power, since there is nothing in Section 1C, or elsewhere in the new legislation, that prohibits the Department from regulating nonenergy-related affiliates.[9] In short, the key question raised by Section 1C is not whether it limits the Department's power to regulate nonenergy affiliates, it clearly does not -- but only whether Section 1C mandates such regulation.

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[9] It has also been held that where, as here, the legislature has amended a statute in part, but has not amended a portion that has already been construed, then the legislature is presumed to have approved the construction. *See Carroll Electric Co. v. Snelling,* 62 F.2d 413, 416 (1st Cir. 1932).

Not only does the statute preserve and enhance the Department's authority to adopt Standards of Conduct and apply them to nonenergy-related affiliates, but the Department's authority to oversee the mitigation of transition costs under the Act provides an additional basis for adopting Standards of Conduct. The statute permits electric utilities to recover stranded investment, or "transition costs" through access charges to electric customers in their service areas. In return for this cost recovery, electric utilities are required, among other things, to take "all reasonable steps" to mitigate these transition costs "to the maximum extent possible." Section 193 (1G)(d)(1). Mitigation includes realizing

> any market value in excess of net book value associated with sale, lease, transfer, or other use of the assets of the company unrelated to the provision of transmission services of distribution service at regulated prices, including, but not limited to, rights-of-way, property, and intangible assets when the costs associated with the acquisition of those assets have been reflected in the company's rates for regulated service; provided, however, that the Department shall determine their market values based upon the highest prices that such assets could reasonably realize after an open and competitive sale….

Sections 189, 193 and (1G) (d)(1), and (2). The Act effectively imposes an obligation to transfer tangible and intangible assets at market, and, thus, to deal with affiliates at arms' length.

This implied obligation parallels requirements of the Department's Standards of Conduct The adoption of Standards of Conduct applicable to non-energy-related affiliates will complement the Department's role in overseeing mitigation of transition costs by providing mechanisms to ensure that utilities meet their mitigation obligations in transactions with nonenergy-related affiliates and will simplify the Department's review of such mitigation.

CONCLUSION

As set forth in Cablevision's initial comments and these reply comments, this proceeding provides the Department with an important opportunity to establish protections for both ratepayers and competitive markets in the Commonwealth of Massachusetts. The extension of the Standards of Conduct will ensure that electric and gas distribution companies do not unfairly use their monopoly distribution franchises in an anti-competitive manner, with ratepayers subsidizing the utilities' nonenergy-related affiliated businesses. Cablevision urges the Department to extend the Standards of Conduct as proposed in the Department's Notice of

Proposed Rulemaking, and includes the additional provisions set forth in Cablevision's initial comments.

Respectfully submitted,

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